Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX

	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 29.23
Updated Jun 08, 2023

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

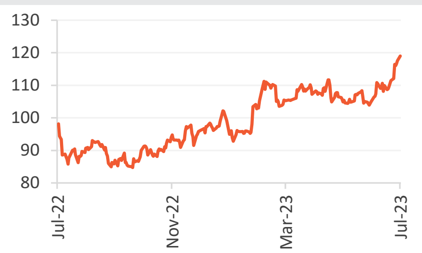
Company details

Market cap:	Rs. 78,244 cr
52-week high/low:	Rs. 123/83
NSE volume: (No of shares)	130.9 lakh
BSE code:	532155
NSE code:	GAIL
Free float: (No of shares)	316.2 cr

Shareholding (%)

Promoters	51.9
FII	16.1
DII	18.1
Others	13.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.9	13.1	23.9	21.2
Relative to Sensex	6.3	0.3	12.5	6.7

Sharekhan Research, Bloomberg

GAIL (India) Ltd

Q1 misses mark; gas transmission to drive growth

Oil & Gas	Sharekhan code: GAIL
Reco/View: Buy ↔	CMP: **Rs. 119**
	Price Target: **Rs. 135** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Standalone PAT of Rs. 1,412 crore (up 134% q-o-q) was 31% below our estimate due to continued losses in the petchem segment, miss in LPG-LHC earnings, lower other income and higher interest costs.
- Gas transmission EBITDA grew strongly by 4.6x q-o-q to Rs. 1,351 crore, reflecting a 7.5% q-o-q rise in gas transmission volume and benefit of tariff revision. Gas marketing EBITDA at Rs. 1,103 crore (up 1.9x q-o-q) was supported by better margins. The petchem segment was hit by lower HDPE prices; LPG-LHC segment witnessed recovery but missed estimate.
- Potential higher tariff and strong volume guidance (123 mmscmd/138-140 mmscmd by end-FY24/FY26) would drive sustained healthy growth for gas transmission business while gas marketing EBITDA guidance of Rs. 3,500 crore is encouraging. Petchem may take time for complete turnaround given subdued petchem prices.
- We maintain a Buy on GAIL with a revised SoTP-based PT of Rs. 135 (reflects higher value for gas transmission). Valuation of 6.5x FY25E EV/EBITDA is at steep discount to historical average of 8.4x and stock offers a healthy dividend yield of 4-5%.

Q1FY24 standalone operating profit/PAT of Rs. 2,433 crore/Rs. 1,412 crore, up 8x/134% q-o-q was 23%/31% below our estimate due to continued EBITDA loss of Rs. 173 crore from the petchem segment, a miss in LPG-LHC EBITDA, lower other income and higher interest costs. Gas transmission/gas trading segment posted strong recovery on sequential basis with EBITDA of Rs. 1,351 crore/Rs. 1,103 crore, up 4.6x/1.9x q-o-q. We highlight here that the gas transmission segment faced an impact of Rs. 172 crore on account of extra fuel costs and a Rs. 66 crore arbitration provision and both the cost are not expected to continue from Q2FY24. Volume performance was strong with a rise of 7.5%/2.5%/35.6%/7.4% q-o-q in gas transmission/gas marketing/petchem/LPG-LHC volumes to 116 mmscmd/99 mmscmd/160 mmt/247 mmt.

Key positives

- Sharp q-o-q rise in gas transmission/gas trading EBITDA.
- Strong volume across segments.

Key negatives

- Petchem segment continued to post EBITDA loss.

Management Commentary

- Gas transmission volume guidance is at 123 mmscmd for FY24 and the company expects a further rise to 138-140 mmscmd by F26. It has submitted review of Rs. 58.61/ mmBtu tariff approved by PNGRB vs. tariff of Rs. 68.6/mmBtu submitted by GAIL.
- Fuel costs for gas transmission to reduce from Q1FY24 levels of $16.6/mmBtu but would remain flat y-o-y for FY24.
- Maintained gas trading EBITDA guidance of Rs. 3500 crore for FY24.
- Petchem to witness q-o-q improvement as volume ramp-up to help better absorption of fixed and LNG cost for petchem segment to also come down from Q1FY24 level of $13/mmBtu.
- FY24 capex guidance of Rs. 9,000-10,000 crore. Q1FY24 capex stood at Rs. 2,400 crore.

Revision in estimates: We have lowered our FY24 earnings estimate by 7% to factor in lower petchem/LPG price and fine-tuned our FY25 earnings estimate.

Our Call

Valuation – Maintain Buy on GAIL with a revised SoTP-based PT of Rs. 135: We expect GAIL to post earnings recovery across business segments in FY24 supported by stabilising global LNG supplies and prices. Valuation of 6.5x FY25E EV/EBITDA is reasonable given a steep discount of 22% as compared to the historical average of 8.4x and expectation of a strong earnings recovery and a healthy dividend yield of ~4-5% on FY24E EPS. Hence, we maintain a Buy rating on GAIL with a revised SoTP-based PT of Rs. 135 (increase reflects higher value for gas transmission business).

Key Risks

1) LNG supply concerns and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilisation, 2) A sharp decline in LNG prices and international oil prices could impact profitability of gas trading, petrochemical, and LPG-LHC segments and 3) Sustained losses in petchem segment in case of volatility in HDPE and spot LNG prices.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	91,626	1,44,250	1,38,499	1,50,337
OPM (%)	15.1	4.6	8.6	9.2
Adjusted PAT	10,364	5,302	8,871	10,156
% YoY growth	111.9	-48.8	67.3	14.5
Adjusted EPS (Rs.)	15.8	8.1	13.5	15.4
P/E (x)	7.5	14.8	8.8	7.7
P/B (x)	1.4	1.4	1.3	1.2
EV/EBITDA (x)	6.0	13.8	7.4	6.5
RoNW (%)	20.3	9.5	15.2	15.9
RoCE (%)	20.3	8.9	14.1	15.0

Source: Company; Sharekhan estimates

Q1 earnings miss estimate on petchem loss & miss in LPG-LHC earnings

Q1FY24 standalone operating profit/PAT of Rs. 2,433 crore/Rs. 1,412 crore, up 8x/134% q-o-q 23%/31% below our estimate due to continued EBITDA losses of Rs. 173 crore from petchem segment, miss in LPG-LHC EBITDA, lower other income and higher interest costs. The petchem segment's profitability was hit by a decline of Rs. 8000/tonne q-o-q in realisation which mean negative margin at gas cost of $13/mmBtu and offset benefit of volume recovery (utilisation of 75% as compared to 67% in Q4FY23 and sales volume growth of 37% q-o-q to 162kt). LPG-LHC segment EBITDA recovery of 54% q-o-q to Rs. 225 crore was also below expectation due to fall in international LPF price while volume stood at 247kt (up 7.4% q-o-q). Gas transmission EBITDA was up strongly by 4.6x q-o-q to Rs. 1351 crore supported by higher tariff of Rs. 58.61/mmBtu and gas transmission volume of 7.5% q-o-q to 116 mmscmd (marginally above estimate of 115 mmscmd). Gas trading EBITDA also grew by 1.9x q-o-q to Rs. 1,103 crore led by higher marketing margin and volume growth of 2.5% q-o-q to 99 mmscmd. The improved volume for gas transmission/gas marketing/petchem was led by resumption of gas supply from its one its Russian suppliers.

Q1FY24 earnings conference call highlights

- **Gas transmission outlook:** GAIL guided that natural gas transmission volume to increase by 6-7% and reach ~123 mmscmd by end-FY24 and further increase to 138-140 mmscmd by FY26. Fuel cost for gas transmission business expected to reduce from the Q1FY24 level of $16.6/mmBtu (as it had impact of carryover of high-cost gas at $40/mmbtu) but would remain at $12/mmBtu (flat y-o-y) for FY24. Fuel consumption was at 1.3-1.4 mmscmd and out of that 0.4 mmscmd is from domestic gas. GAIL has submitted a review of the Rs. 58.61/ mmBtu tariff approved by PNGRB as compared to tariff of Rs. 68.6/mmBtu submitted by GAIL. The company has a benefit of ~Rs. 660 crore from increase in integrated transmission tariff to Rs. 58.61/mmBtu.
- **Gas marketing outlook:** The maintained its guidance of Rs. 3500 crore of EBITDA from gas marketing business for FY24 given normalising global LNG supply.
- **Petchem outlook:** The management indicated that performance of petchem segment would improve q-o-q over Q2FY24-Q4FY24 but refrained to give any specific guidance given volatile HDPE prices. The company highlighted that the petchem business would be break-even at current petchem price and delivered LNG price of $10/mmBtu. Q1FY24 average LNG prices for petchem segment was at $13/mmBtu.
- **Q1FY24 one-offs.** Transmission one-offs were at Rs. 238 crore in Q1FY24 which included - Rs. 172 crore on account of extra fuel cost and Rs. 66 crore arbitration provision.
- **Capex guidance:** The management guided for capex of Rs. 9,000-10,000 crore for FY24. Break-up – Pipeline/petchem/operational/CGD/equity investment at Rs. 4,000 crore/Rs. 3,200 crore/Rs. 700 crore/Rs. 200 crore/Rs. 350 crore. GAIL had spent Rs. 9100 crore on capex in FY24.
- **Key project updates:** For the Mumbai-Nagpur Jharsuguda Pipeline the Mumbai- Nagpur section comprising of 698 Km is expected to be completed by December 2023. Jagdishpur-Haldia-Bokaro-Dhamra pipeline 2,550 km out of 3,291 Km has been commissioned while remaining portion is expected to be completed by June 2024.
- **GAIL CGD business:** Gail has an infrastructure of 154 CNG stations and 2.7 Lakh D-PNG connections. Q1FY24 gas sales volumes stood at 0.3 mmscmd. The company stated that the target for the next two years is 100 CNG stations and 2 lakh D-PNG stations.
- **GAIL Gas:** Q1FY24 revenues/PAT stood at Rs. 2,192 crore/Rs. 76 crore versus Rs. 2522 crore/Rs. 67 crore in Q4FY23. The gas sales volume remained largely flat q-o-q at 5.3 mmscmd. GAIL Gas (along with JVs and subsidiaries) has 456 CNG stations and 8.7 lakh D-PNG connections. GAIL is evaluating for monetization of CGD assets.

Results (standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenues	**32,212**	**37,562**	**-14.2**	**32,843**	**-1.9**
Total Expenditure	29,779	33,197	-10.3	32,536	-8.5
Operating profit	**2,433**	**4,366**	**-44.3**	**307**	**692.0**
Other Income	268	180	48.9	1,017	-73.7
Interest	176	48	265.4	90	94.7
Depreciation	636	603	5.4	643	-1.1
PBT	1,889	3,894	-51.5	591	219.6
Tax	477	979	-51.3	-13	NA
Reported PAT	**1,412**	**2,915**	**-51.6**	**604**	**134.0**
Equity Cap (cr)	658	658		658	
Reported EPS (Rs.)	2.1	4.4	-51.6	0.9	134.0
Margins (%)			**BPS**		**BPS**
OPM	7.6	11.6	-407	0.9	662
Tax rate	25.2	25.1	10	-2.1	2738
NPM	4.4	7.8	-338	1.8	255

Source: Company, Sharekhan Research

Segmental EBITDA Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Natural gas transmission	1,351	1,090	23.9	297	354.9
LPG transmission	96	100	-4.0	97	-1.0
Natural gas trading	1,103	2,402	-54.1	576	91.5
Petrochemicals	-173	169	NA	-257	NA
LPG and Liquid hydrocarbons	225	663	-66.1	146	54.1
Others	98	121	-19.0	465	-78.9
Total EBITDA	**2,700**	**4,545**	**-40.6**	**1,324**	**103.9**

Source: Company, Sharekhan Research

Segment-wise volume performance Rs cr

Segmental volumes	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Natural gas transmission (mmscmd)	116	109	6.3	108	7
LPG transmission (kmt)	1,073	1,055	1.7	1,079	-0.6
Natural gas trading (mmscmd)	99	101	-2.0	96	2.5
Petrochemicals (kmt)	160	109	46.8	118	35.6
LPG and Liquid hydrocarbons (kmt)	247	220	12.3	230	7.4

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Regulatory push to drive gas demand, volatile spot LNG/LPG/HDPE price a near term concern

Long-term growth outlook for gas transmission volumes of gas utilities remains intact supported by robust gas demand outlook driven by: 1) Higher demand from power, CGD, and fertiliser sectors and 2) Regulatory push for a shift to gas from polluting industrial/automobile fuels. In addition, the recent revision in gas pipeline tariff norms by the regulator bodes well for higher transmission tariff going forward. However, volatile spot LNG/LPG/HDPE price remains key concern for profitability of commodity business (like gas trading, petrochemical and LPG) under pressure.

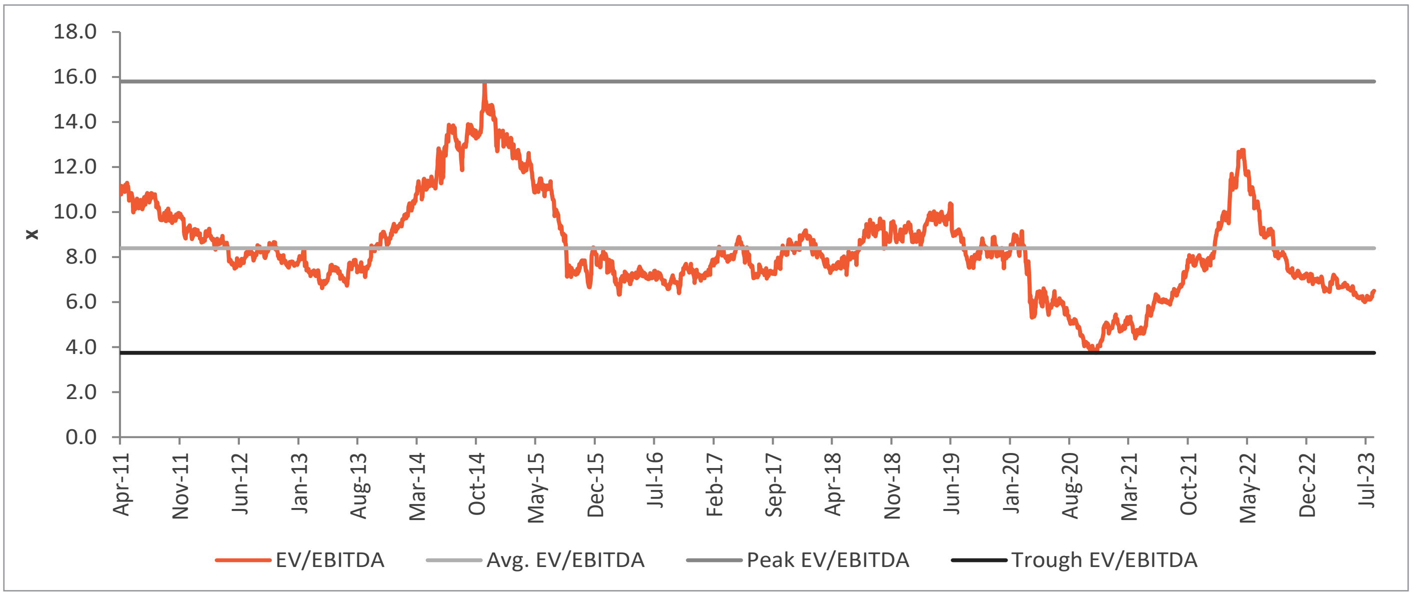
■ Company outlook - Improving earnings outlook as gas supply concern eases

After a dismal show in FY23, we expect GAIL's earnings to witness a strong recovery in FY24 supported by an improving outlook across its business segments. Gas transmission would benefit from higher tariff/volume; petchem to turnaround on improved LNG supply and lower gas cost while LPG-LPG margin to improve from the APM gas price cap. Management expects trading EBITDA of Rs. 3,500 crore annually. Overall, we expect 67% y-o-y PAT growth for GAIL in FY24

■ Valuation - Maintain Buy on GAIL with a revised SoTP-based PT of Rs. 135

We expect GAIL to post earnings recovery across business segments in FY24 supported by stabilising global LNG supplies and prices. Valuation of 6.5x FY25E EV/EBITDA is reasonable given a steep discount of 22% as compared to the historical average of 8.4x and expectation of a strong earnings recovery and a healthy dividend yield of ~4-5% on FY24E EPS. Hence, we maintain a Buy rating on GAIL with a revised SoTP-based PT of Rs. 135 (increase reflects higher value for gas transmission business).

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

About company

GAIL is a dominant domestic gas utility company primarily engaged in gas transmission and marketing businesses. The company owns ~14,617 km of gas pipelines and markets two-third of gas sold in India. GAIL also owns and operates gas-based petrochemical plants with a capacity of 880 ktpa and LPG-LHC production facilities. The company also holds a substantial interest in the city gas distribution (CGD) business with stakes in CGD companies or through subsidiaries. GAIL also owns LNG import terminals.

Investment theme

Strong long-term gas demand supported by a favourable regulatory environment and improving gas supplies (through upcoming LNG terminals and higher domestic gas production) bode well for improvement in GAIL's gas transmission volumes in the next 2-3 years. We expect GAIL's earnings to witness a strong recovery in FY24 supported by an improving outlook across its business segments given the normalization of global LNG supply and prices. GAIL's valuation is attractive and stock offers healthy divided yield.

Key Risks

- Continued LNG supply concern and lower-than-expected ramp-up of domestic gas supply could impact volume for gas transmission/marketing/petchem utilization,
- A sharp decline in LNG price and international oil prices could affect profitability of gas trading, petrochemical, and LPG-LHC segments.
- Sustained losses in petchem segment in case of volatility in spot LNG and HDPE price.

Additional Data

Key management personnel

Sandeep Kumar Gupta	Chairman and MD
Rakesh Kumar Jain	Director (Finance)
M.V. Iyer	Director (Marketing)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.1
2	SBI Funds Management Ltd	2.52
3	Indian Oil Corp Ltd	2.48
4	HDFC Asset Management Co Ltd	1.91
5	Vanguard Group Inc/The	1.75
6	BlackRock Inc	1.15
7	Norges Bank	0.92
8	ICICI Prudential Asset Management	0.8
9	FMR LLC	0.63
10	Dimensional Fund Advisors LP	0.62

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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